

# The complex indirect tax challenges of NFTs in South Africa

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Before looking at the taxation of NFTs, it is important to understand what they are. In short, an NFT, or non-fungible token, is a unique blockchain-based digital asset. Being unique in its properties, an NFT cannot be duplicated and the content linked to it could take any digital form, for example, an image, piece of music, video or any other digital content that could be traded or exchanged on an NFT market. Arguably, an NFT is defined by its value, and not by its unique properties.



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Some NFTs have also been created to be used as access tokens to exclusive social clubs, such as the bored ape yacht club (BAYC). These NFTs act like access tickets, entitling their owners access to exclusive digital services and spaces.

With the oftentimes booming crypto market, particularly the trade in NFTs for often staggering amounts of money, tax authorities globally have raised their eyebrows to the potential tax implications of the NFT market.

## NFTs within the global tax framework regulating digital services

Currently, a globally accepted and comprehensive solution to the taxation of NFTs remains indistinct. This is due to the fact that the tax treatment of NFTs would require various considerations as to their characterisation and application within existing global tax rules. Another potential issue is the valuation of NFTs for tax purposes, as there is limited guidance in this respect. Therefore, tax authorities appear to be caught playing catch-up. In some cases, however, there are tax authorities who are of the view that the current legislative measures are sufficient to cater for the taxation of NFTs.



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To establish whether VAT would apply on the supply of NFTs, it is important to first establish whether the supply of NFTs

would comprise a supply of electronic services, as defined. On a global scale, the existing definitions of electronic services, per the European Union Council Directive 2006/112/EC, the Council Implementing Regulation (EU) No 282/2011 and the United Nations Model Convention 2021, may potentially be broad enough to include NFTs within the ambit of the definition of electronic services, specifically as it caters for the taxation of automated digital services that involve minimal human interaction. It is unlikely that the lawmakers had an explicit intention to cater for NFTs when these provisions were made, however, the wording of these provisions was broadened to the extent that it catered for future developments in the digital economy.

## An overview of Spain's tax treatment of NFTs

The Spanish Tax Authorities (STA) recently issued a ruling on this matter after considering that NFTs, being essentially 'digital certificates of authenticity', created two different digital assets after minting, ie. the underlying digital asset (being the image, music, video, etc.) that can be digitally presented, and the NFT itself, which represents the digital ownership of certain rights over the underlying digital asset. In their rationale for this conclusion, the STA emphasized that NFTs could not fall within the scope of the supply of goods as they did not entitle the purchaser to any rights over tangible property. Consequently, there was no delivery of an actual asset and therefore, the supply should be subject to VAT.

## Could South Africa take a similar approach?

The South African VAT legislation defines electronic services, subject to certain specific exclusions, as any services supplied by means of an electronic agent, electronic communication or the internet, for any consideration. It is evident that a supply that is dependent on information technology, is automated, and involves minimal human intervention, would fall within this definition. However, before concluding that the supply of an NFT would fall into this definition for South African VAT purposes, it is necessary to consider whether it would, for purposes of the Value Added Tax Act, 1991 (VAT Act), be considered a supply of services.



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According to the VAT Act, goods are corporeal movable things, fixed property and any real right in such fixed property, while fixed property is specifically defined as land, sectional title units and shares in a share block scheme. Services on the other hand means anything done or to be done including the granting, assignment, cession or surrender of any right or making available any facility or advantage. Having regard to these very specific definitions, it is clear that the supply of an NFT, not being a tangible, moveable thing, cannot be regarded as a supply of goods, but rather that it constitutes a supply of services. Considering it is supplied electronically, it can be concluded that the supply of NFTs should fall within the scope of the definition of electronic services and would therefore attract South African VAT.

## Concluding comments

As simple as this seems, we caution that it becomes more complex, specifically when taking into account how blockchains function. For a non-resident supplier to be considered to be supplying electronic services in South Africa, that supplier would need to supply to a South African resident customer or a customer with a residential, postal or business address in South Africa, and payment would be made by that customer from a South African bank account. A major consideration in this regard is the anonymity of blockchain transactions and thus the difficulty, if not unfeasibility, for the seller to determine the identity and location of the purchaser of the NFTs in question.

In essence, this makes enforcement of VAT obligations on non-resident suppliers of NFTs extremely difficult, if not unlikely, and therefore currently creates a loophole. Considering the staggering amounts for which NFTs are sold in the digital markets, this is certainly an area in which tax authorities could place more focus, rather than having to play catch up with innovative digital transformation.

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